ECONOMIC COMMENTARY

Economics | South Africa

26 February 2020

NEDBANK

National Budget 2020

Key points

- Budget deficits remain high over the medium term, with rising debt. Limited fiscal consolidation is achieved through increased spending disciplines rather than increased taxation.
- The arithmetic again worsens from the earlier estimates, largely due to weaker-than expected economic growth.
- The consolidated budget **deficit** rises to 6,8% of gross domestic product (GDP) in 2020/21 from 6,3% in 2019/20 (previously budgeted at 4,5% and then revised to 5,9% in October's Medium Term Budget Policy Statement). The deficit then eases, falling to 5,7% by 2022/23. The figures are similar to what we had expected. This means that **gross public debt** rises to 71,6% of GDP in 2022/23 from the current 61,6%. Net loan debt rises to 67,8% in 2021/22 from 57,0% in 2019/20.
- **Revenue** again disappointed in 2019/20 due to the weak economy. Tax revenue is estimated to have undershot by 4,2%, largely due to lower income tax collections from individuals and companies and disappointing VAT revenues. In 2020/21 tax revenues are expected to grow by 4,9%. Individual tax rates remain the same with very little compensation for fiscal drag, while other adjustments mainly just allow for inflation. The focus will instead be on rebuilding capacity at SARS and restoring the public's trust in the institution.
- **Expenditure** in 2019/20 was lower than the revised MTBPS estimate. Spending is projected to grow by 6,0% this year. Annual increases will then fall below 5%. Treasury has focused on the massive wage bill, on efficiencies and on reducing waste in efforts to keep spending under control. The expenditure ceiling was cut by R156,1 billion over the next three years.

The 2020 national budget was again delivered against the background of a deteriorating fiscal position. Growth has been consistently below potential since 2014, tax collection capabilities are slowly on the mend but were severely compromised during the Zuma administration, and it has been difficult to contain spending after the poor discipline of the same era. The crumbling State Owned Enterprises (SOEs) have added another dimension to the crisis. These became spending machines, doling out largesse but with little lasting benefits to show.

Minister Tito Mboweni's task was again difficult this year – he had to try and reduce deficits and keep debt at sustainable levels against the background of an unresponsive economy and a government that continually announces but then delays necessary structural reforms. Investors and ratings agencies have got understandably less patient as the state delays implementing its own plans on reforming areas such as the energy and telecommunications markets. Moody's, the last ratings agency to have South Africa on an investment grade ranking, again needed to be convinced not to downgrade the sovereign to subinvestment grade.

In response to these growing pressures, Treasury has proposed nothing new on the revenue side of the budget, arguing that the weak economy is unable to withstand additional burdens. Higher revenue will be driven by inflation and hoped for improvements in tax administration. Instead, this budget concentrates on government spending, proposing cutting the remuneration bill from last year's medium term plans, and greatly increasing spending efficiencies.

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Economic background and assumptions

Economic growth deteriorated further in 2019 as electricity supply constraints and a difficult policy environment continued to hurt consumer and investor confidence. Simple, easily effected and impactful reforms such the deregulation of the electricity market and the release of telecommunication spectrum remain elusive, while government has muddied the waters in other areas, such as mining legislation, proposals for a state bank and a sovereign wealth fund, land reform and an overly ambitious, but confidence-sapping National Health Insurance agenda. We estimate the economy to have grown by just 0,3% last year, although a major rebasing exercise could alter the final figure. This is in line with Treasury's estimate. Their medium-term forecasts are more optimistic than our own, although they show a similar pattern. Our growth forecasts are around 0,2 percentage points lower than Treasury's in each year. We have consistently assumed that long-promised structural reforms will become a reality, but this has proved too optimistic and downside risks to the forecast are therefore more prevalent. The uncertainty and disruptions being caused by the outbreak of the coronavirus (COVID-19) will also hurt prospects, at least in the short term.

Lower-than-anticipated inflation has also hurt revenue collections and these conditions are set to continue into the early part of the budgeting period. Weak domestic demand, low rand passthrough effects and low global inflation have kept prices under control. Treasury's forecasts are in line with the consensus. Despite upside risks posed by administered prices and a weaker rand, inflation centred around the mid-point of the Reserve Bank's 3% to 6% target range seems likely over the medium term.

Table 1 : Economic assumptions

	2016	2017	2018	2019	2020	2021	2022
Real GDP	0.4	1.4	0.8	0.3	0.9	1.3	1.6
Real HCE	0.6	2.1	1.8	1.1	1.1	1.3	1.6
Real GFCF	-3.5	1.0	-1.4	-0.4	0.2	1.3	1.9
Current account (% of GDP)	-2.9	-2.5	-3.5	-3.4	-3.4	-3.5	-3.7
Consumer inflation (%)	6.3	5.3	4.7	4.1	4.5	4.6	4.6

Source: National Treasury Budget Review 2020

Budget arithmetic

The key consolidated budget figures are set out in table 2. It details the estimated outcome for the current fiscal year (2019/20), which ends in March, compared with the originally budgeted figures a year ago, as well as the budgeted figures over the next three years. The estimates at the time of the MTPBS in October 2019 are also shown. The figures are considerably worse than those expected a year ago and even reflect a deterioration from the extremely poor framework set out in October.

Table 2 : Consolidated budget 2020

	2019/20			2020/21		2021/22		2022/23	
	Budget Feb 2019	MTBPS Oct 2019	Outcome Feb 2020	MTBPS Oct 2019	Budget Feb 2020	MTBPS Oct 2019	Budget Feb 2020	MTBPS Oct 2019	Budget Feb 2020
Revenue (Rbn)	**1583.8**	**1537.9**	**1517.0**	**1618.5**	**1583.9**	**1729.6**	**1682.8**	**1841.2**	**1791.3**
% gdp	*29.3*	*29.5*	*29.4*	*29.3*	*29.2*	*29.4*	*29.2*	*29.3*	*29.2*
Yoy%	*8.8*	*6.4*	*5.0*	*5.2*	*4.4*	*6.9*	*6.2*	*6.4*	*6.4*
Expenditure (Rbn)	**1826.6**	**1844.1**	**1843.5**	**1978.7**	**1954.4**	**2097.5**	**2040.3**	**2214.9**	**2141.0**
% gdp	*33.7*	*35.4*	*35.7*	*35.8*	*36.0*	*35.6*	*35.4*	*35.3*	*34.9*
Yoy%	*9.7*	*11.6*	*12.2*	*7.3*	*6.0*	*6.0*	*4.4*	*5.6*	*4.9*
Balance (Rbn)	**-242.7**	**-306.2**	**-326.6**	**-360.2**	**-370.5**	**-367.9**	**-357.5**	**-373.7**	**-349.7**
% gdp	*-4.5*	*-5.9*	*-6.3*	*-6.5*	*-6.8*	*-6.2*	*-6.2*	*-5.9*	*-5.7*
Gdp (Rbn)	**5413.8**	**5210.8**	**5157.3**	**5530.3**	**5428.2**	**5893.1**	**5759.0**	**6283.0**	**6126.3**
Yoy%	*7.0*	*5.9*	*4.8*	*6.1*	*5.3*	*6.6*	*6.1*	*6.6*	*6.4*

Source: National Treasury Budget Review 2020, MTBPS October 2019, Budget Review 2019

Expenditure

'Over the past five years, the majority of efforts to reduce the deficit have come through tax increases. The 2020 Budget centres the consolidation effort on expenditure, by reducing compensation growth. The aim is to reduce spending as a share of GDP, and improve the composition of spending.' (Budget Review 2020)

Table 3 : Government expenditure at a consolidated level

	Budget 2020/21		Annualised changes	
	Annual %change	% of total	2019/20 2022/23	2016/17 2019/20
General public services	**8.9**	**17.2**	**9.3**	**7.8**
of which: State debt costs	*11.8*	*11.7*	*12.3*	*11.9*
Defense	**1.1**	**2.6**	**-0.3**	**2.1**
Public order & safety	**2.0**	**8.2**	**3.3**	**6.1**
Police services	*1.8*	*5.6*	*3.3*	*6.3*
Law courts	*3.0*	*1.3*	*3.6*	*5.7*
Prisons	*1.7*	*1.3*	*3.3*	*5.5*
Economic affairs	**7.6**	**13.3**	**-0.1**	**13.0**
General economic, commercial & labour affairs	*3.0*	*1.9*	*5.0*	*5.2*
Agriculture, forestry, fishing & hunting	*-3.8*	*1.3*	*1.5*	*6.2*
Fuel & energy	*23.4*	*3.7*	*-16.4*	*83.6*
Mining, manufacturing, construction	*7.5*	*0.1*	*1.0*	*2.5*
Transport	*5.6*	*5.3*	*5.5*	*4.7*
Communication	*-29.5*	*0.2*	*-10.7*	*12.9*
Economic affairs not elsewhere classified	*13.9*	*0.3*	*3.7*	*6.1*
Environmental protection	**-0.9**	**0.7**	**1.0**	**8.2**
Housing & community amenities	**7.4**	**9.4**	**7.2**	**5.7**
Health	**3.5**	**11.5**	**5.0**	**7.8**
Recreation & culture	**7.8**	**0.8**	**3.2**	**3.9**
Education	**2.8**	**20.0**	**4.1**	**9.7**
Social protection	**8.5**	**16.1**	**6.3**	**9.5**
Subtotal: functional classification	**5.7**	**99.7**	**5.0**	**8.5**
Total consolidated expenditure	**6.0**	**100.0**	**5.1**	**8.5**
Remuneration	***1.5***	***32.7***	***3.5***	***7.1***

Source: National Treasury Budget Review 2020

- National Treasury has over the past few years concentrated on additional revenue proposals to reduce the budget deficit, this year the consolidation effort was aimed at expenditure and especially government's wage bill.
- After reaching a historic high of 36% of GDP in 2019, Treasury in this budget decided to cut the expenditure ceiling by R156,1 billion over the next three years. This is approximately 1% of GDP.
- The net reduction is mainly the result of reductions to baselines of R261 billion (this includes a R160,2 billion reduction to the wage bill – R37,8 billion in 2020/21, R54,9 billion in 2021/22 and R67,5 billion in 2022/23) as well as reallocations and additions of R111,1 billion, which include an amount of R60,1 billion that has been set aside for Eskom and SAA (R16,4 billion). Government will transfer R112 billion to Eskom over the next three years to meet its short-term obligations.
- Treasury believes that the reduction in the wage bill will be achieved through a combination of changes to cost-of-living adjustments, pay progression and other benefits. If successful, these changes will see the consolidated wage bill shrink by 1% in real terms over the medium term. Treasury states that the wage bill, which has grown by approximately 40% over the past 12 years, has started crowding out capital expenditure and spending on other projects necessary for service delivery.

- At 15,2% of main budget revenue in 2019/20 from 9,8% in 2010/11, debt-service costs remain the fastest growing expenditure item.
- The breakdown of expenditure by function shows that the largest proportion of expenditure in 2020/21 will be learning and culture (R396,4 billion), followed by social development (R309,5 billion) and then health (229,7 billion).
- Non-interest expenditure is forecast to grow at 3,8% over the next three years from an average growth rate of 8,4% over the previous three years. This is a real annual contraction of 0,4% over the next three years.

Revenue

'Government will not raise additional revenue from tax proposals in 2020/21' (Budget Review 2020)

Projected gross tax revenue for 2019/20 at R1,3 trillion is R10,7 billion lower than estimated at the October Medium Term Budget Policy Statement and R63,3 billion lower than forecasted at the 2019 Budget. According to Treasury, the latest under-recovery exceeds even that recorded in 2009/10, immediately after the financial crisis, with the recent shortfall mainly the result of lower economic growth.

Table 4 : Revenue estimates

	2020/21			Proposals	2019/20
	(Rm)	% growth	% of tax	(Rm)	(% overshoots)
Consolidated revenue	**1583599**	**4.4**			**-4.2**
Provincial and other revenue	**185604**	**7.8**			**-4.5**
National revenue	**1397996**	**4.0**			**-4.2**
Other revenue	**35973**	**-0.5**			**14.6**
Less SACU payments	63395	26.1	4.4	0	0.0
Tax revenue	**1425418**	**4.9**	**100.0**	**0**	**-4.4**
Incomes and profits	**813588**	**4.5**	**57.1**	**-2000**	**-5.1**
Individuals	546771	3.6	38.4	-2000	-4.6
Other companies	230226	6.2	16.2	0	-5.6
STC	31808	6.9	2.2	0	-8.8
Other	4783	12.9	0.3	0	-19.5
Payroll and workforce	**19413**	**4.5**	**1.4**	**0**	**-1.0**
Skills dev fund	19413	4.5	1.4	0	-1.0
Property	**17510**	**9.2**	**1.2**	**0**	**-6.5**
MST	6866	11.4	0.5	0	-5.0
Transfer duties	7621	5.3	0.5	0	-10.3
Other	3023	14.8	0.2	0	1.1
Goods and services	**514267**	**5.2**	**36.1**	**2000**	**-3.2**
VAT	360555	4.8	25.3	0	-4.5
Fuel levy	83441	5.3	5.9	0	-4.4
Excise duties	48836	4.4	3.4	0	10.4
Electricity levy	8100	0.9	0.0	0	-6.3
Other	13335	27.7	0.9	2000	1.3
International trade	**60640**	**5.8**	**4.3**	**0**	**-6.5**
Customs duties	59500	5.6	4.2	0	-6.2
Other	1140	13.5	0.1	0	-21.0
Stamp duties & fees	**0.071**	**-**	**0.0**	**0**	**-**
Memorandum items:					
Direct taxes	836024	4.6	58.7	-2000	-5.0
Indirect taxes (net)	589393	5.4	41.3	2000	-3.6

Source: National Treasury Budget Review 2020

Given the struggling economy and the already elevated tax-to-GDP ratio (at an estimated 26,3% in 2020/21), Treasury made the decision not to raise additional revenue from taxes in 2020/21. The focus will instead be on rebuilding capacity at SARS and restoring the public's trust in the institution.

The 2020/21 tax proposals are therefore few. Additional revenue from indirect taxes – the carbon tax (R1,75 billion) and the plastic bag levy (R0,25 billion), will be offset by personal income tax relief of R2 billion. Other tax proposals include:

- Limiting companies' abilities to fully offset assessed losses from previous years against taxable income.
- Increasing the annual limit of tax-free savings accounts by R3 000 to R36 000.
- Increasing the fuel levy by 25 cents/litre (16c/l for the general fuel levy and 9c/l for the Road Accident Fund levy)
- Raising excise duties on alcohol and tobacco by between 4,4% and 7,5%.
- Limiting corporate interest deductions.

Tax revenues are expected to grow by 4,9%, 6,1% and 6,4% in 2020/21, 2021/22 and 2022/23 respectively.

Financing

'Debt is not projected to stabilise over the medium-term, and debt-service costs now absorb 15,2% of main budget revenue.' (Budget Review 2020)

Table 5 : Financing the National Budget

	2018/19	2019/20		2020/21	2021/22	2022/23
R billion	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Domestic short-term loans (net)	**14.1**	**25.0**	**36.0**	**48.0**	**48.0**	**55.0**
Treasury bills	14.0	15.0	26.0	48.0	48.0	55.0
Corporation for Public Deposits	0.0	10.0	10.0	0.0	0.0	0.0
Domestic long-term loans (net)	**169.5**	**185.4**	**279.4**	**285.2**	**278.2**	**262.9**
Market loans (gross)	183.5	216.0	299.2	337.7	337.4	385.8
Loans issued for switches	-0.5		-0.3			
Redemptions	-13.5	-30.6	-19.5	-52.5	-59.2	-122.9
Foreign loans (net)	**23.2**	**-21.0**	**25.8**	**17.0**	**40.5**	**38.0**
Change in cash and other balances	**24.6**	**65.8**	**-3.7**	**17.7**	**-0.3**	**3.5**
Total	**231.3**	**255.2**	**337.5**	**368.0**	**366.4**	**359.3**

- Gross loan debt is now firmly above the 60% of GDP mark. Debt is estimated to rise to 65,6% of GDP in 2020/21 from 61,6% in 2019/20 and then increase to 69,1% in 2021/22 and 71,6% in 2022/23.
- Contingent liabilities are expected to rise from an estimated R979,9 billion in 2019/20 to R1,16 trillion in 2022/23.
- The 2019/20 public-sector borrowing requirement is estimated at R410 billion or 7,9% of GDP. For 2020/21, 2021/22 and 2022/23 the borrowing requirement is R432,7 billion (8,0% of GDP), R429,9 billion (7,5%) and R497,5 billion (8,1%).
- Domestic capital markets remain the main source of financing over the medium-term.

Other issues

- Eskom has begun the process of separating its three operating activities and Treasury says that each will soon have its own board and management structure.
- The Budget Review also reiterated what was said in the State of the Nation address about expanding private sector electricity generation capacity by amongst other things purchasing additional electricity from IPPs, opening bid window 5, obtaining 2000 to 3000 megawatts of additional emergency power within 3 months to a year of approval and permitting municipalities to buy power from the private sector.

Assessment

In the absence of economic growth boosting revenues sufficiently to keep debt under control, government has had to start making tougher choices. In this budget Treasury has decided to leave tax rates unchanged, largely because these levers have proved ineffective in recent years. Instead the focus is now on keeping spending under control. Given the waste of the past few years (as evidenced by the Auditor General's reports) this is the correct approach. However, for this approach to work it will have to cut deep into well-connected, entrenched vested interests, ranging from unions to beneficiaries of badly executed procurement policies. This has proven to be very difficult in the past. If the minister and Treasury do not get the necessary support and actions, then finances are going to deteriorate at an alarming pace over the medium term.

The key remains boosting economic growth over the medium term. This budget stresses the need for structural economic reform. It says all the right things, but again more general support and action is needed. Unless urgent action is taken to improve the business environment and include the private sector in solutions for key infrastructural backlogs and other service provision, potential growth is going to continue declining.